

The Performance of Microfinance Institution (A Study on Rural Banks in Indonesia)

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Abstract— The purpose of this paper is to overview the rural banks in Indonesia in three dimensions: institutional, operational and performance. Rural bank is one of microfinance institution in Indonesia which categorized as a bank-type. The performance of rural bank is important because, with the two missions, profit-oriented as well as for social welfare, MFI should keep its sustainability by maintaining both financial and non-financial performance. During the last 5 years (2008-2012) the performance of rural banks in terms of institutional, operational and financial ratio is good. However, the source of third-party funds in the form of saving should be improved. Furthermore, the portion of credit for the business interests should bigger than the others. By adapting socio-cultural system approach will reduce the microfinance's risk.

Keywords—microfinance; rural bank; performance

I. INTRODUCTION

Microfinance Institution (MFI) as an economic development tool intend to benefit low-income people as a client. The major objective is to provide the financial services to the poverty section that has been denied by the commercial bank. The goal of MFIs is to service the financial needs of unserved or underderved markets. By the services, MFIs provide substantial assistance, both social and economic welfare to build relationships with various stakeholders such as governments, consumers, suppliers, non-governmental organizations and other stakeholders that could ultimately extend the network and social capital of the micro-entrepreneurs.

Since 1980s Microfinance Institutions (MFIs) as new alternative financial services have been introduced in Indonesia. Currently, more than 95% of the economic sector in Indonesia is dominated by micro, small and medium enterprises (MSMEs). With their characteristics: scattered widely throughout rural areas, dominated by women with self-employment without wage-paid workers, traditional entrepreneurs with low productivity, largely produce basic goods, low value-added, particularly for local markets and likely to play an important role in developing the talents of villagers [1], they lack accessibility to formal financial institution in order to comply their financial for investment [2]. Means, this is a great opportunity for the development of microfinance to better provide access to financial services for MSMEs.

However, studies suggest that these benefits of microfinance can only be realized as long as the poor continue to be clients of microfinance institutions [3]. Means, that the positive impact of MFIs on the socio-economic welfare can only be achieved if the institutions to be sustainable. The

financial sustainability of microfinance institutions is a necessary condition for institutional sustainability [4]. How MFI supervised its sustainability is reflected by its performance. MFI's performance is about outreach and its financial performance [5]. The performance measurement of MFI becomes very important for both internal as well as extern interest. For policy makers, it can be used as input to regulate the MFIs in order to continue to grow and have an impact on economic development. For consumers, the performance of MFIs is considered to participate in the financial services. For investors or donors, the performance will be the consideration for decision making of investment. For its own internal MFI, it will be the basis for improvement in terms of both institutional and operational.

This paper discusses the performance of the Rural Bank, which is one type of MFIs in Indonesia. Of interest from this is that the Rural Bank although categorized MFI, but the institutional and operational rules referring to the bank. Consequently, Rural Bank must work harder to survive in the financial markets, and on the otherhand, it should also be able to realize its social mission for social welfare.

II. MICROFINANCE INSTITUTION

Microfinance is the provision of small scale financial services to low income or unbanked people [6]. According to [5], the term refers to the provision of financial services to low-income clients, including the self-employed. Financial services generally include savings and credit; however, some microfinance organizations also provide insurance and payment services. In addition to financial intermediation, many MFIs provide social intermediation services such as group formation, development of self-confidence, and training in financial literacy and management capabilities among members of a group. Thus the definition of microfinance often includes both financial intermediation and social intermediation. Microfinance is not simply banking, it is a development tool.

Other definition is from [7], microfinance is the provision of a broad range of financial services such as, deposits, loans, payment services, money transfers and insurance, to poor and low-income households and their microenterprises. It also shares the concept that low-income individuals are capable of lifting themselves out of poverty if given access to financial services

How microfinance is provided depends on political and economic environment of a country. These will be a consideration of government economic and social policies that influence microfinance organization in the delivery of

financial services to the poor. Ledgerwood [5] divided microfinance institution based on whom the suppliers:

1. Formal financial institutions are chartered by the government and are subject to banking regulations and supervision. They include public and private banks, insurance firms, and finance companies. When these institutions serve smaller business or farmers, there is potential for them to move into the microfinance sector.
2. Semiformal institutions are not regulated by banking authorities but are usually licensed and supervised by other government agencies. These financial institutions which vary greatly in size typically serve midrange clients associated by a profession or geographic location and emphasize deposit mobilization.
3. Informal financial intermediaries operate outside the structure of government regulation and supervision. They include local moneylenders, pawnbrokers, self-help groups, and NGOs, as well as the savings of family members who contribute to the microenterprise.

Microfinance services can be performed by government, individuals, private sector, NGOs, Financial Institutions formal or informal. Microbanking is how banking is a formal financial institution should be able to serve the micro sector, which is generally informal, or how the informal sector micro can enter the formal banking sector.

Microfinance is a good tool in poverty alleviation but it has also become a good business. Today, MFIs are divided between two contrasting views of microfinance. The more mission-oriented and socially-driven view is represented by the Grameen Bank and the well-known online lending platform Kiva. The more commercially-driven view is represented by the recently gone public and profitable organizations Compartamos in Mexico and SKS Microfinance in India. Patricia Werhane, Laura Hartman and Charles Wankel among others would argue that alleviating poverty through profitable institutional partnerships is an ethical and innovative business possibility bringing prosperity and economic inclusion [8][9].

Meeting the full promise of microfinance – to reduce poverty without ongoing subsidies – requires translating high repayment rates into profits, a challenge that remains for most microbanks. The overall equation linking capital and labour inputs into profits and social change still proves difficult to master [10].

According to Bank Indonesia, MFI is divided into two categories: bank and non-bank. MFIs with bank-type are: BRI Unit Desa, BPR (rural bank), and BKD (Village Credit Institutions). Whereas the non-bank are: credit cooperatives (KSP), savings and loan units (USP), rural credit funds (LDKP), Baitul Mal wattanwil (BMT), nongovernmental organizations (NGOs), social gathering, the pattern of Grameen financing, financing patterns ASA, self-help groups (SHGs), and the credit union. Overall, there are 143,211 MFIs (Banks and Cooperatives) and 43,681 MFIs (Non-Banks and Non-Cooperatives) spread throughout Indonesia, serving of at least 355,516,000 of clients.

III. RURAL BANK

Bank Perkreditan Rakyat (Rural Bank) is a financial institution that accepts deposits only in the form of time deposits, savings deposits, and /or other equivalent forms of it have and distribute the fund for society [11].

Rural bank should be able to serve the needs of farmers, ranchers, fishermen, traders, small businessmen, employee, and retired as the un-bankable targeted by commercial banks and to realize the equity in banking services, the equity of income distribution, and to minimize get funding from moneylenders. Moreover, rural bank must avoid the free fight liberalism, etatisme and monopoly. Running banks in low-income communities is not easy. One of the great accomplishments of the economics of information, after all, has been to show how information asymmetries undermine credit markets in places where potential customers have few assets to offer as collateral [12].

The functions of rural bank are: (1)Provide banking services to communities that are difficult or no access to commercial banks; (2)Help the government to educate the public in order to understand national patterns acceleration on development in the rural sector; (3)Creating equality in business opportunities, especially for rural communities; (4)Educate and accelerate people's understanding of the use of agency formal financial to avoid moneylender [13].

The main activities of rural bank include to collect and to distribute funds with the profits purpose. Rural bank's profits derived from interest income and spread effect. These activities include: (1)Collect funds from the public in the form of savings and deposits, and/or other equivalent forms of it, (2)Give credit, (3)Provides financing to customers based on the principle of profit-sharing accordance with the conditions set out in the Regulation, (4)Deposit in Bank of Indonesia Certificates (SBI), time deposits, certificate of deposits, and/or savings to another bank.

Rural bank is prohibited for: (1) Accepting deposits such as current accounts, (2) Conducting foreign exchange, (3) Conducting equity with prudent banking principles; (4) Conducting insurance business.

IV. PERFORMANCE OF RURAL BANKS

About the institution, since government launched regulation at October 1988, rural bank has been grown on a rapid increase. In the end of March 2003, data shows that the number of rural banks is 2,741 offices, consist: 2,133 head offices, 138 of branch offices 138, and 470 branch office cash. Although the number of rural bank's office continues to increase, but since 2005, there is a downward trend of the number of rural bank. It recorded 2,009 rural banks in 2005, but at the end of 2012 the number of rural banks fell to 1,653 units, or drops until 17.7%. While the number of offices increase with average number of 42.3% (in 2008-2012).

A decrease in the number of rural banks and the growth in the number of offices (branches) is one of the effects of government policy (in this case the Bank of Indonesia) in limitation of the working area. Rural bank is confined on a

province to run the financial activities, no longer inter-provincial. Previously, it can be covered to each other, that effect in higher cost and more difficulty in controlling.

TABLE 1. GROWTH OF TOTAL RURAL BANKS (UNITS)

Number of Rural Bank	2005	2006	2007	2008	2009	2010	2011	2012
Total Rural Banks	2009	1880	1814	1772	1773	1706	1669	1653
Total Bank Offices	3110	3173	3250	3367	3644	3910	4172	4425

The performance of rural banks in the last five years (2008-2012) continue to show significant increased on their main activities (collect and distribute the funds). Rural banks, by only 2% from total of commercial banks continue to increase the number of debtors and creditors (savings and deposits). In 2012, there were 9,370,234 customers who were able to donate funds amounting to Rp. 44.869 billion (over the last five years has grown by an average of 20%). Time deposits are still popular among clients to save their funds in rural banks, which have more than 60% of total third party. One of the reasons is the interest rate of time deposit is higher (about 40%) than the savings.

TABEL 2. THIRD PARTY FUNDS OF RURAL BANK (2008-2012) (BILLION RUPIAH)

Source of Third Party	2008	2009	2010	2011	2012
Savings	7135	8272	9857	12035	14468
Time deposits	14204	17280	21455	26174	30401
Total	21339	25552	31312	38209	44869

In 2012, total credit of rural banks increased about 95% over the previous five year, or 18.3% on average growth, amounting to Rp. 49 818 Billion. Start from 2008, the portion of credit for consumption usage was the biggest compared to working capital and investment. At that time, it noted 48% of total credit is used to consumption, 46% for working capital and the rest is investment. A change of proportion in funding distribution in rural bank is influenced by interest rates. Interest rate for consumption is the lowest (26%) compared two others (31% working capital dan 27% for investment)

TABEL 3. CREDIT OF RURAL BANK BASED ON TYPE OF USE (BILLION RUPIAH)

Type of Use of Fund	2008	2009	2010	2011	2012
Working capital	13007	14169	16790	19577	23030
Investment	1846	1579	1929	2362	2964
Consumption	10619	12619	15126	19178	23824
Total	25472	28001	33844	41117	49818

Rural bank's financial performance in the last five years (2008-2012) also showed a positive trend. There was a positive trend of Loan to Deposit Ratio (LDR) which is the ratio between the total credits with funds received by rural banks. It recorded 82.54% (in 2008), and declined to 78.54% (in 2011). This ratio indicates a liquidity assessment. The lower ratio indicates the better liquidity of rural bank. This illustrates that the ability of rural banks to collect funds from third parties (creditors) is greater than the amount of funds distributed for debtors. The lowest LDR also suggests that the greater of customer's trust given to rural bank.

Return on Assets (ROA) ratio is used to measure the ability of management BPR in overall profit. In five-year cumulative (2008-2012), the ROA is seen increase of 32% (2.61% in 2008 to 3.46% in 2012). The bigger of the ROA indicates the greater of profits that the bank achieved and the better the position of the bank in terms of asset utilization.

Return on Equity (ROE) is the ratio between the net incomes of the bank's own capital. It provides important information for the stakeholders, especially for investors in the capital market who concern to buy shares of the bank. The increase in this ratio means an increase in the net profit of the bank. Consequently, it will lead to rise in bank stock prices. Rural bank's ROE in 2008-2012 had a tendency to increase, which in 2008 amounted to 22.67% and continued to increase up to 32.63% in 2012 (with 9.54% in average).

Other indicator of rural bank's performance is NPL (Non-Performing Loans), which is the ratio between non-current credits to total credits. The lower level of NPL indicates the better performance in reducing the risk of the loan. In 2008, the NPL was 9.88% could be reduced doubled to 4.75% in 2012.

TABEL 4. PERFORMANCE OF RURAL BANK (%)

Performance	2008	2009	2010	2011	2012
LDR	82.54	79.61	79.02	78.54	81.11
NPL	9.88	6.9	6.12	5.22	4.75
ROA	2.61	3.08	3.16	3.32	3.46
ROE	22.67	25.08	26.71	29.46	32.63

5. CONCLUSION

According to the number of credits and deposits growth, rural bank is slightly better than commercial bank. On the contrary, the rate of NPL of rural bank was higher than commercial bank. It worsens the other performance by reducing the rate of ROA. This was caused by the competition of third party. The bigger number of time deposits than savings will be so costly. Next, due to the presence of rural bank is to sustain funding of SMEs, it is necessary to be considered for allocating greater credit for working capital and investment purposes than consumption.

There are still challenges for rural bank to strengthen the performance. First, the consistency of rural bank in serving customers with the socio-cultural approach could produce loyalty from clients. Another advantage is the strong personal relationships with its customers. Rural bank is able to provide financial as well as non-financial service by face to face. BPR is also able to adjust the conditions, customs, culture and life of the surrounding community.

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